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In the Supreme Court of the United States

OCTOBER TERM, 1991

INSLAW, INC., PETITIONER

v.

UNITED STATES OF AMERICA, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT*

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the government's use of computer software in its possession violated the automatic stay triggered by the filing of a bankruptcy petition because the government's rights to the software were the subject of a contract dispute with the debtor.

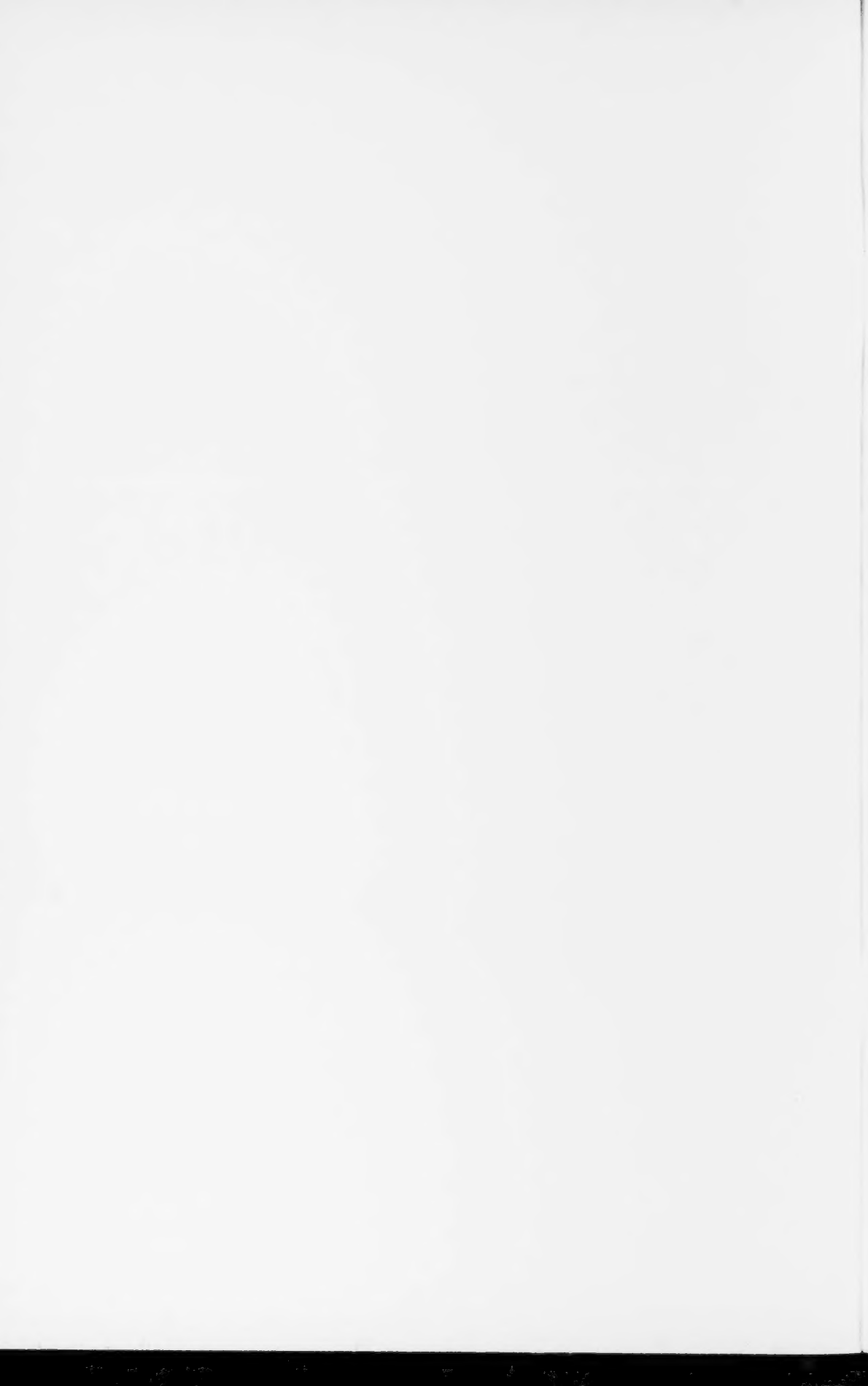


TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	7
Conclusion	15

TABLE OF AUTHORITIES

Cases :

<i>Charter Co., In re</i> , 913 F.2d 1575 (11th Cir. 1990)	11, 14
<i>Chick Smith Ford, Inc., In re</i> , 46 Bankr. 515 (Bankr. M.D. Fla. 1985)	11
<i>Computer Communications, Inc., In re</i> , 824 F.2d 725 (9th Cir. 1987)	9
<i>FLR Co., In re</i> , 58 Bankr. 632 (Bankr. W.D. Pa. 1985)	11
<i>First Nat'l Bank v. Cope</i> , 385 F.2d 404 (1st Cir. 1967)	8
<i>Gallucci, In re</i> , 931 F.2d 738 (11th Cir. 1991)	11
<i>Gardner, In re</i> , 913 F.2d 1515 (10th Cir. 1990)	12, 13
<i>Kincaid, In re</i> , 917 F.2d 1162 (9th Cir. 1990)	12, 13
<i>Knaus v. Concordia Lumber Co.</i> , 889 F.2d 773 (8th Cir. 1989)	11, 12
<i>M.S.V., Inc., In re</i> , 97 Bankr. 721 (D. Mass.), appeal dismissed, 892 F.2d 5 (1st Cir. 1989)	11
<i>Missouri v. United States Bankruptcy Court</i> , 647 F.2d 768 (8th Cir. 1981), cert. denied, 454 U.S. 1162 (1982)	11
<i>Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.</i> , 458 U.S. 50 (1982)	6, 13
<i>Satelco, Inc., In re</i> , 58 Bankr. 781 (Bankr. N.D. Tex. 1986)	11
<i>Small Business Admin. v. Rinehart</i> , 887 F.2d 165 (8th Cir. 1989)	9
<i>United States v. Whiting Pools, Inc.</i> , 462 U.S. 198 (1983)	8

IV

Statutes and rule:

Page

Bankruptcy Amendments and Federal Judgeship

Act of 1984, Pub. L. No. 98-353, 98 Stat. 333... 13-14

28 U.S.C. 157 14

Bankruptcy Code, 11 U.S.C. 101 *et seq.*:

11 U.S.C. 362 (a) 7, 8, 10, 12

11 U.S.C. 362 (a) (3) 4, 7, 8, 10

11 U.S.C. 362 (d) - (f) 10

11 U.S.C. 541 (a) (1) 4

11 U.S.C. 542 5

11 U.S.C. 542 (a) 8

Contract Disputes Act of 1978, 41 U.S.C. 601

et seq. 10

Miscellaneous:

H.R. Rep. No. 595, 95th Cong., 1st Sess. (1978) 7

S. Rep. No. 989, 95th Cong., 2d Sess. (1978) 7

In the Supreme Court of the United States

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-17a) is reported at 932 F.2d 1467. The district court's memorandum opinion (Pet. App. 19a-56a) is reported at 113 Bankr. 802. The opinion of the bankruptcy court (Pet. App. 59a-236a) is reported at 83 Bankr. 89.

JURISDICTION

The judgment of the court of appeals (Pet. App. 18a) was entered on May 7, 1991. A petition for rehearing was denied on July 12, 1991. Pet. App. 1a. The petition for a writ of certiorari was filed on October 9, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This bankruptcy dispute arises out of a contract between petitioner, Inslaw, Inc., and the Department of Justice. The contract required Inslaw to install case-tracking computer software called the Prosecutors Management Information System (PROMIS), which had been developed by Inslaw's predecessor, a non-profit corporation known as the Institute for Law and Social Research, with grants from the Justice Department's Law Enforcement Assistance Administration. It is undisputed that the version of PROMIS developed by the Institute is in the public domain. Pet. App. 5a.

In 1981, following a pilot project pursuant to which PROMIS was installed in two U.S. Attorneys' offices, the Justice Department decided to install PROMIS in 20 additional large U.S. Attorneys' offices and the Executive Office for United States Attorneys. Accordingly, in March 1982 Inslaw received a \$9.6 million contract to install computers and the existing publicly-funded version of PROMIS in those offices over a three-year period. The contract also called for Inslaw to develop and install a wordprocessor-based version of PROMIS in the other U.S. Attorneys' offices. Pet. App. 6a. In accordance with the contract, installation of the necessary hardware in the larger U.S. Attorneys' offices did not take place immediately. Instead, as required by the contract, the software was made available on a time-sharing basis on the computers in Inslaw's offices.

In November 1982, pursuant to the terms of the contract, the Justice Department asked Inslaw for a copy of the software it was using through the time-sharing arrangement. That request touched off a dispute between the parties because Inslaw responded

to the government's request by stating that the software on the computers in Inslaw's offices was not the public domain version of PROMIS that Inslaw had agreed to install, but instead allegedly included proprietary enhancements. Pet. App. 6a. After negotiations, the parties agreed that, pending resolution of their dispute over ownership of the enhanced version of PROMIS, Inslaw would deliver a copy of software that included the enhancements to the Department and the Department agreed to "limit and restrict the dissemination of the said PROMIS computer software to the Executive Office for United States Attorneys, and to the 94 United States Attorneys' Offices covered by the Contract." *Id.* at 7a. This agreement became Modification 12 to the contract.

By early 1985, Inslaw had nearly completed installation of the enhanced version of PROMIS at the larger U.S. Attorneys' Offices and the Executive Office for United States Attorneys, and had "received almost all of the original \$9.6 million contract price." Pet. App. 8a. But the dispute over the ownership of the enhancements had not been resolved. On February 7, 1985, Inslaw filed a reorganization petition in the bankruptcy court. The government's contract with Inslaw expired by its terms in March 1985. The government then implemented copies of the PROMIS software supplied by Inslaw in 23 additional U.S. Attorneys' offices. *Ibid.*

2. In 1986, Inslaw initiated this adversary proceeding against the Department of Justice and the United States. Inslaw claimed that the government had violated the automatic stay triggered by the filing of a bankruptcy petition, which prohibits "any act to obtain possession of property of the estate or of

property from the estate or to exercise control over property of the estate.” 11 U.S.C. 362(a)(3).

The bankruptcy court granted relief. It concluded that prior to the filing of the bankruptcy petition, the Department fraudulently had induced Inslaw to execute Modification 12 by promising to negotiate regarding the enhancements and then had failed to negotiate in good faith. The court reasoned that the failure to cure the pre-petition fraud violated the automatic stay. Pet. App. 228a-229a. The court issued an order awarding approximately \$6.8 million in damages and \$1 million in attorney’s fees. *Id.* at 9a.

The district court affirmed the bankruptcy court’s orders. Although the Department took vigorous issue with the bankruptcy court’s factual findings as well as its legal analysis, the district court addressed none of the many specific factual findings challenged by the Department. Nor did it analyze the Department’s software rights under the original contract or Modification 12. The district court concluded that because the Department of Justice was aware of Inslaw’s view that its software contained proprietary enhancements, all of the pre-petition and post-petition installations of the software violated the automatic stay, even if the Department was actually entitled to the use of the enhanced software. Pet. App. 51a.

3. A unanimous panel of the court of appeals reversed. Pet. App. 3a-17a. The court recognized that the automatic stay protects “property of the estate,” which includes “all legal or equitable interests of the debtor in property as of the commencement of the case.” *Id.* at 10a-11a, quoting 11 U.S.C. 541(a)(1). The court reasoned that the Department had not exercised control over the property of

the estate merely because Inslaw asserted a proprietary interest in the software in the Department's possession. To rule otherwise, the court observed, would mean that "[w]henever a party against whom the bankrupt holds a cause of action (or other intangible property right) acted in accord with his view of the dispute rather than that of the debtor-in-possession or bankruptcy trustee, he would risk a determination by a bankruptcy court that he had 'exercised control' over intangible rights (property) of the estate." Pet. App. 12a. The court explained that this "view of § 362(a) would take it well beyond Congress's purpose," which was primarily "to make sure that creditors do not destroy the bankrupt estate in their scramble for relief." *Id.* at 13a-14a. The court added that "[f]ulfillment of that purpose cannot require that every party who acts in resistance to the debtor's view of its rights violates § 362(a) if found in error by the bankruptcy court." *Id.* at 14a.

The court of appeals also stated that Inslaw's interpretation of the automatic stay could not be reconciled with the recognized limitations of the "turnover" provision of the Bankruptcy Code, 11 U.S.C. 542, which requires third parties to return property and pay debts to the debtor upon the filing of a bankruptcy petition. The court observed that "[i]t is settled law that the debtor cannot use the turnover provisions to liquidate contract disputes or otherwise demand assets whose title is in dispute." Pet. App. 11a. However, Inslaw's interpretation of the automatic stay, which "would turn every act of the possessor that implicitly asserts his title over disputed property into a violation of § 362(a)," would eviscerate the limitations on the turnover provisions, giving "the bankruptcy court jurisdiction over all such

disputes, creating a kind of universal end-run around the limits on turnover.” *Id.* at 15a.

In addition, the court of appeals noted that Inslaw’s reading of the automatic stay provision would allow a bankruptcy court to adjudicate traditional contract actions as part of its “core” jurisdiction. As the court observed, this Court in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), held that Congress could not vest in bankruptcy courts the power to adjudicate traditional contract actions where the action was not integral to the restructuring of the debtor-creditor relationship. In response, Congress provided that bankruptcy courts may enter final judgment only as to “core” matters, and may enter only proposed findings of fact and conclusions of law as to related “non-core” matters. Pet. App. 12a-13a. The court of appeals stated that “[i]n asking us to allow the bankruptcy court to decide a wide range of ‘non-core’ disputes under the guise of an automatic stay violation, Inslaw ignores *Northern Pipeline* and Congress’s response.” *Id.* at 13a.

The court of appeals also observed that the bankruptcy court had held pre-petition as well as post-petition conduct to violate the automatic stay. The court stated that this holding “appears to have left the words of the statute in the dust.” Pet. App. 16a. The court stressed that “[t]he automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate. Nowhere in its language is there a hint that it creates an affirmative duty to remedy past acts of fraud or bias or harassment as soon as a debtor files a bankruptcy petition.” *Ibid.*

The court added that Inslaw had not been left without legal remedies. The court emphasized that “Ins-

law retains whatever intangible property rights it had in enhanced PROMIS at the time of filing. If the Department has violated the contract or Modification 12, Inslaw as debtor-in-possession has all the access to court enjoyed by any victim of a contract breach by the United States government. If Modification 12 was induced by fraud, as the bankruptcy court found, then Inslaw has its contract remedies or perhaps a suit for conversion." Pet. App. 15a.

ARGUMENT

The decision below does not conflict with any decision of this Court or any other court of appeals and presents no issue warranting this Court's review. Contrary to petitioner's contentions, the court of appeals faithfully adhered to both the statutory language and the policies underlying the automatic stay provision.

1. a. Petitioner's claims are predicated entirely upon alleged violations of the Bankruptcy Code's stay of "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. 362(a)(3). The purpose of the stay is to give "the debtor a breathing spell from his creditors," temporarily freeing him from collection efforts and foreclosure actions, and to protect other creditors. H.R. Rep. No. 595, 95th Cong., 1st Sess. 340-342 (1978); S. Rep. No. 989, 95th Cong., 2d Sess. 54-55 (1978).

As an initial matter, it is clear that the stay, which is triggered by the filing of a bankruptcy petition, necessarily applies only to post-petition conduct. The opinions of the bankruptcy court and the district court, on which petitioner relies, ignore this essential characteristic of Section 362(a), and the factual find-

ings of the bankruptcy court cited by petitioner are concerned primarily with pre-petition conduct. The court of appeals clearly was correct in emphatically rejecting the bankruptcy court's holding that Section 362(a) required the Department to cure alleged pre-petition misconduct, a critical underpinning of the bankruptcy court's decision. Pet. App. 16a.

b. The court of appeals was equally correct in holding that the Department at no time after the filing of the bankruptcy petition "exercise[d] control" over petitioner's property within the meaning of Section 362(a) (3).

As the court of appeals noted, petitioner indisputably had no possessory interest in the PROMIS software that was used by the Department. Contrary to Inslaw's contention, Pet. 12, possession is frequently crucial to determining the applicability of the stay provision. If the debtor possesses the property, the property may not be seized even if the seizing party holds an undisputed ownership interest in the property. In those instances, it is the possessory interest itself that is the "property of the estate." That was the situation in the paradigm case of *First Nat'l Bank v. Cope*, 385 F.2d 404 (1st Cir. 1967), relied upon by petitioner, Pet. 14, and the district court, Pet. App. 51a, where the court held that a bank could not repossess the debtor's car after bankruptcy even though the debtor had defaulted.¹

¹ There is no basis for Inslaw's assertion that *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), supports the proposition that "the automatic stay applies regardless of when respondent obtained possession of the debtor's property," Pet. 12. The Court held in that case that a turnover order could issue against the IRS under 11 U.S.C. 542(a). The automatic stay provision was not at issue.

Of course, the property of the estate includes rights other than possessory rights. For example, the automatic stay would generally preclude garnishment of wages or other interference with monies indisputably owing to the estate. It is clear, however, that the filing of a bankruptcy petition does not transform controverted property into property of the estate.² Thus, at the time it filed its bankruptcy petition, Inslaw had a claim that it had a proprietary interest in the enhanced PROMIS software and the government owed it money in order to use the software. But the software in the government's possession did not become property of the estate simply because Inslaw asserted a proprietary claim and a right to increased compensation.

The ramifications of Inslaw's position are sweeping. Debtors are frequently entangled in contract disputes at the time of bankruptcy. In petitioner's view, the subject matter of these contract disputes would be transmuted into "property of the estate" by the filing of a petition and third parties would use the property at their peril. This extraordinary expansion of the estate is without any basis in the language or policies

² Cases relied on by petitioner illustrate the principle that the estate has a right to monies indisputably owed to the debtor. See *Small Business Admin. v. Rinehart*, 887 F.2d 165 (8th Cir. 1989) (government could not set off statutory payments to which the debtor was indisputably entitled without obtaining relief from the stay). The principle has been applied to preclude the unilateral termination of an executory contract. *In re Computer Communications, Inc.*, 824 F.2d 725 (9th Cir. 1987). However, nothing in these cases suggests that the subject of an unadjudicated contract dispute with the debtor is transformed by the filing of a bankruptcy petition into property of the estate shielded by the automatic stay.

of the automatic stay. To the contrary, as the court of appeals stressed, the stay is not violated whenever someone already in possession of property “refuses to capitulate to a bankrupt’s assertion of rights in that property.” Pet. App. 14a.³

Indeed, the facts of this case illustrate the extent to which, under Inslaw’s theory, the estate’s claim of right would create property of the estate. Shortly after filing for bankruptcy, Inslaw filed a claim under the Contract Disputes Act of 1978, 41 U.S.C. 601 *et seq.* that was substantially identical to its claim that the Justice Department had violated the automatic stay provision. Pet. App. 8a. Petitioner subsequently abandoned its claim under the Contract Disputes Act and never asserted a contract claim in bankruptcy court. Nevertheless, under Inslaw’s reading of Section 362(a), its abandoned contract claim rendered the Department’s continued use of the software an exercise of control over Inslaw’s property. The court of appeals properly declined to accept this unprecedented interpretation of the automatic stay.

c. Moreover, under petitioner’s reading of Section 362(a)(3), a debtor could compel the return of property under the automatic stay provision even though the debtor could not obtain the property pursuant to the turnover provisions of the Code. As the court of appeals observed, “[i]t is settled law that the debtor cannot use the turnover provisions to liquidate contract disputes or otherwise demand assets whose title

³ Petitioner suggests that third parties with contract disputes with a debtor should seek relief from the automatic stay pursuant to 11 U.S.C. 362(d)-(f). Pet. 14-15. But the stay only has effect (and so relief from the stay is only needed) where a third party interferes with the property of the estate.

is in dispute.” Pet. App. 11a, citing *In re Charter Co.*, 913 F.2d 1575 (11th Cir. 1990); *In re Satelco, Inc.*, 58 Bankr. 781, 786 (Bankr. N.D. Tex. 1986); *In re Chick Smith Ford, Inc.*, 46 Bankr. 515, 518 (Bankr. M.D. Fla. 1985); *In re FLR Co.*, 58 Bankr. 632, 634-635 (Bankr. W.D. Pa. 1985). See also *In re M.S.V., Inc.*, 97 Bankr. 721, 728-729 (D. Mass.) (damage award unavailable under Section 542 because “the clear limits inherent in the statutory language restrict the Bankruptcy Judge’s authority to orders directing return of *undisputed* property or monies”), appeal dismissed, 892 F.2d 5 (1st Cir. 1989).⁴ Thus, petitioner’s construction of the automatic stay would expand debtors’ rights far beyond the limits set by Congress. Indeed, it would anomalously broaden the automatic stay provision to authorize turnover actions not authorized by the turnover provision.⁵

⁴ Neither *In re Gallucci*, 931 F.2d 738 (11th Cir. 1991), nor *Missouri v. United States Bankruptcy Court*, 647 F.2d 768 (8th Cir. 1981), cert. denied, 454 U.S. 1162 (1982), relied on by petitioner, Pet. 13 n.10, are to the contrary. In *Gallucci*, 931 F.2d at 743, the court held that the bankruptcy court erred by ordering the turnover of property where “the debtor never had an interest in the * * * property.” In *United States Bankruptcy Court*, 647 F.2d at 773, the court held that a debtor’s possessory interest in stored grain together with its undisputed minor ownership interest were sufficient to confer bankruptcy jurisdiction over the property. In neither case did the opinion even vaguely suggest that bankruptcy courts should resolve contract disputes to determine whether to order a turnover.

⁵ In *Knaus v. Concordia Lumber Co.*, 889 F.2d 773, 775 (8th Cir. 1989), relied on by petitioner, Pet. 13, the court held that the failure to turn over property seized prior to the filing of a bankruptcy petition would violate the automatic stay. The correctness of this holding is doubtful. As the

2. Contrary to petitioner's assertions, the decision below does not impose new limits on bankruptcy jurisdiction and does not leave bankruptcy courts powerless to deal with allegations of misconduct. The court of appeals simply held that petitioner had failed to demonstrate a violation of Section 362(a), the only ground for recovery asserted, and that petitioner accordingly was not entitled to relief.

Inslaw's contention that the decision below improperly precluded the bankruptcy court from determining the "property of the estate" is mistaken. Pet. 18. At the time of the filing of the petition, the estate did not possess an adjudicated proprietary interest in the alleged enhancements to the PROMIS software. If Inslaw had pursued its contract claim and had prevailed, it would have been entitled to contract damages. But even if Inslaw had ultimately prevailed in a contract dispute, the Department would not have been placed retroactively in violation of the automatic stay.⁶

court of appeals acknowledged in that case, the general rule is that the automatic stay provision is violated only when an entity fails to turn over property taken from the estate after the petition is filed. 889 F.2d at 775 & n.1. In any event, *Knaus* is very different from this case because the property that was at issue there was indisputably subject to the turnover provision. 889 F.2d at 774-775. Where property is not subject to the turnover provision, as in the present case, authorizing a turnover pursuant to the automatic stay provision would create "a kind of universal end-run around the limits on turnover." Pet. App. 15a.

⁶ Neither *In re Kincaid*, 917 F.2d 1162 (9th Cir. 1990), nor *In re Gardner*, 913 F.2d 1515 (10th Cir. 1990), relied on by petitioner for the proposition that bankruptcy courts can determine the extent of the property of the estate, Pet. 18, suggest that bankruptcy courts are to resolve contract dis-

3. As the foregoing indicates, the court of appeals' decision flows from its interpretation of the Bankruptcy Code and does not squarely raise any constitutional issue as to the scope of the bankruptcy courts' jurisdiction. Although the court of appeals recognized that acceptance of Inslaw's position would "raise severe constitutional problems," Pet. App. 13a, the court did not rest its decision on this ground.

Moreover, although constitutional concerns were not central to the court's holding, the court was clearly correct in recognizing that acceptance of petitioner's view would implicate the concerns underlying this Court's decision in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), which struck down the bankruptcy court system established by the Bankruptcy Reform Act of 1978. In *Northern Pipeline v. Marathon*, *supra*, the Court held unconstitutional provisions permitting the bankruptcy courts to enter final judgments in state law contract actions which, although related to the bankruptcy case, were not integral to the restructuring of the debtor-creditor relationship. In response, when Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, it limited the bankruptcy courts' power to adjudicate matters that are only "related" to the bankruptcy case. Thus, Congress allowed the bank-

putes to determine stay violations or to order turnovers. In *Kincaid*, 917 F.2d at 1168, the court determined that a debtor's undisputed interest in a pension plan did not render the monies in the plan property of the estate subject to the Code's turnover provisions. In *Gardner*, 913 F.2d at 1518, the court held that the bankruptcy court lacked jurisdiction over a turnover action because the "case involves the conflict between two creditors over property no longer a part of the bankruptcy estate."

ruptcy courts to enter final judgment on matters integral to the bankruptcy scheme, so-called "core" matters. However, with respect to non-core matters related to the bankruptcy case, in the absence of consent from the parties bankruptcy courts may enter only proposed findings of fact and law. 28 U.S.C. 157.

Petitioner's sweeping interpretation of the automatic stay provision eliminates those carefully crafted distinctions by permitting bankruptcy courts to enter final judgment on property and contract actions that are only "related" to the bankruptcy case. Contrary to Inslaw's contentions, this unprecedented reading is in no way necessary to permit the bankruptcy courts to effectuate the automatic stay. Where a third party seeks to obtain property from the estate, or fails to acknowledge an undisputed claim by the estate, the jurisdiction of the bankruptcy courts to adjudicate the dispute is unquestioned. But the grant of jurisdiction to enforce the automatic stay does not empower the bankruptcy courts to resolve all manner of disputes. Indeed, the limitations on the bankruptcy court's core jurisdiction underlie the decisions holding that the turnover provisions may not be used to compel the return of disputed property. *In re Charter Co.*, 913 F.2d at 1579.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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DECEMBER 1991

* The Solicitor General is disqualified in this case.